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No. 96-1462

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1996

CHRISTOPHER H. LUNDING,
BARBARA J. LUNDING,

Petitioners,

v.

TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK, COMMISSIONER OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

Respondents.

On Writ of Certiorari to the
Court of Appeals of the State of New York

BRIEF OF THE STATES OF OHIO, ARKANSAS, CALIFORNIA, HAWAII, IDAHO, ILLINOIS, MISSOURI, MONTANA, NORTH CAROLINA, UTAH, VERMONT, WEST VIRGINIA AND WISCONSIN

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STATEMENT OF *AMICI* INTEREST

Amicus State of Ohio and 12 other *amici* States write to urge the Court to affirm the decision of the New York Court of Appeals and to explain why the issue presented matters not just to New York but to her sister States as well.

The *amici* States all raise revenue in order to supply vital governmental services to residents and non-residents alike, and do so through a variety of taxes, including income, sales and property taxes. In supporting New York in this case, the *amici* States wish to ensure that what has long been true in performing this vital government task remains so -- namely, "in taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Austin v. New Hampshire*, 420 U.S. 656, 661-62 (1975) (citation omitted).

Attempting to alter this bedrock principle, petitioners invoke the privileges and immunities clause to propose a constitutional rule of rigid equality between expenses deductible for residents and expenses deductible for nonresidents, even though the States have power to tax fully only the income of the former but not the income of the latter. The proposal disregards the long-respected flexibility given to the States in levying taxes, ignores case law from this Court upholding similar tax classifications and in the final analysis jeopardizes many other tax classifications deployed by the States which are equally reasonable in nature. For these reasons and those added below, we respectfully submit this brief.

SUMMARY OF ARGUMENT

The privileges and immunities clause, to be sure, prevents States from singling out nonresidents for disfavorable treatment. *Austin v. New Hampshire*, 420 U.S. 656 (1975). But, in doing so, it does not require the States

to establish "precise equality" between the two groups. *Travellers' Ins. Co. v. Connecticut*, 185 U.S. 364, 371 (1902). In view of the different stance of residents and nonresidents when it comes to paying taxes and sharing the revenue generated by them, the States may treat the two groups differently -- as long as they do not create "unreasonable" distinctions between them, *Shaffer v. Carter*, 252 U.S. 37, 57 (1920), and as long as they provide a "reasonably fair distribution of burdens" between them, *Travellers' Ins.*, 185 U.S. at 371. Nor for like reasons does the clause markedly intrude upon the States' traditional flexibility "to pursue [their] own fiscal policies" through a variety of tax classifications. *Wisconsin v. J.C. Penney*, 311 U.S. 435, 444 (1940). *See also Austin*, 420 U.S. at 661-62. All that the clause asks of the States is that they create reasonable distinctions in principle which create substantial equality in effect between the two groups.

Examined under this test, New York clearly passes. As an initial matter, the privileges and immunities clause does not require New York to create parallel tax requirements for residents and nonresidents because the due process clause does not permit it. While the States may tax all income of their residents, whether earned in-State or not, due process prohibits them from taxing the income of nonresidents earned outside their State. Thus, on the income side of the equation, New York has drawn the same constitutionally-required distinction that all 39 income-tax States draw: It imposes a global income tax on all income of its residents, but only a partial income tax on the New York-derived income of its nonresidents.

Under these circumstances, it was well within New York's fiscal powers to adhere to this jurisdictional limit on the deduction side of the equation. Having limited its taxation of nonresidents to in-State income, New York quite

legitimately chose to limit the availability of deductions to expenses incurred in earning that income. Thus, residents may take all customary income tax deductions for personal expenses, be they for alimony, life insurance, property taxes, individual retirement accounts, and the like, while nonresidents may not. The distinction of course flows not from any animus to out-of-staters, but from the reasonable (and constitutionally-required) restriction against taxing all income of nonresidents and the sensible fiscal decision not to grant a tax windfall to nonresidents.

In implementing this policy, New York has simply taken the view that alimony payments do not represent an income-earning expense related to New York, but represent a legal requirement unique to social policies (specifically the marriage laws) of the State of the taxpayer's residence. In neither design nor effect does this reasonable system violate the privileges and immunities clause.

In *Shaffer v. Carter*, 252 U.S. 37 (1920), the Court approved a similar method of income attribution and expense deduction. It allowed the State to deny nonresidents a deduction for business losses incurred outside the taxing state, even though the State authorized residents to take such a deduction. Because "jurisdiction extends only to [nonresidents'] property owned within the state and their business, trade, or profession carried on therein," the Court found "no obligation to accord to them a deduction by reason of losses elsewhere incurred." *Id.* at 56-57. *See also Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 73 (1920) (allowing New York to limit nonresident deductions to those related to the generation of New York income). In the last analysis, alimony obligations, like the out-of-state business losses in *Shaffer*, have no connection to the generation of nonresident income in the State and thus any deduction for such expenses properly may be limited to the State of residence.

A contrary approach would not only doom New York's statute but would also place at risk other income-tax deduction laws. Many States follow New York's situs-based approach with respect to alimony and other personal expenses.

ARGUMENT

I. State Distinctions Between Resident And Nonresident Taxpayers Meet The Requirements Of The Privileges And Immunities Clause If They Are Reasonable In Nature And Substantially Equal In Effect.

Under the Constitution of the United States, "[t]he Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." U.S. Const., Art. IV, section 2. Like the full faith and credit clause that precedes it, the privileges and immunities clause ensures comity among the States and prevents individual States from isolating themselves and the benefits they provide from other States and from other States' citizens. *See Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 180 (1869) ("It was undoubtedly the object of the clause in question to place the citizens of each state upon the same footing with citizens of other states, so far as the advantages resulting from citizenship in those states are concerned.").

Yet the clause imposes only a relative duty on the States, not an absolute one. The clause has never been construed to require States to treat residents and nonresidents alike with mathematical precision. States thus need not extend the franchise to nonresidents, need not provide the same college tuition breaks to nonresidents that they provide to residents, and in matters of taxation need not (because they

cannot) tax the same amount of income from residents that they tax from nonresidents.

In view of the legitimate differences in kind between residents and nonresidents, the clause gives the States ample latitude to respect those differences in drawing legal classifications in general and tax classifications in particular. Accordingly, State tax measures are valid under the clause so long as they are reasonable in nature, the Court has held: The measures just cannot be "unreasonable," *Shaffer v. Carter*, 252 U.S. 37, 57 (1920), they must have a "reasonable ground for the diversity of treatment," *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 79 (1920), they must be based on a "'reasonable relationship'" between the status of residents and nonresidents, *Hicklin v. Orbeck*, 437 U.S. 518, 525-26 (1978) (quoting *Toomer v. Witsell*, 334 U.S. 385, 396 (1948)), and they must provide a "reasonably fair distribution of burdens," *Travellers' Ins. Co. v. Connecticut*, 185 U.S. 364, 371 (1902). There thus is no requirement of "precise equality" in the treatment of residents and nonresidents, *Travellers' Ins*, 185 U.S. at 371, and the clause does not bar "disparity of treatment in the many situations where there are perfectly valid independent reasons for it." *Toomer v. Witsell*, 334 U.S. 385, 396 (1948). All the clause requires of State legislators is that distinctions between residents and nonresidents be reasonable in nature and lead to "substantial equality in treatment." *Austin v. New Hampshire*, 420 U.S. 656, 665 (1975).

The modest nature of these requirements heeds the traditional discretion given to the States in matters of taxation. As one of the Court's more recent privileges-and-immunities decisions reiterates, "in taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Austin*, 420 U.S. at 661-62 (quoting

Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973) and *Madden v. Kentucky*, 309 U.S. 83, 88 (1940)).

II. New York's Treatment Of Residents And Nonresidents Meets These Modest Requirements.

A. Due Process Requires The States To Treat The Income Of Residents Differently From The Income Of Nonresidents.

In sizing up New York's statute against these standards, it initially is worth emphasizing an option that neither New York nor any other State has in legislating in this area. All agree that the State could not have met Mr. Lunding's allegation by enacting the most equal and most comity-driven of income tax statutes -- one that taxed all income (no matter where earned) of residents and nonresidents and one that permitted residents and nonresidents to take all deductions (no matter how loosely connected to earnings) in computing their income tax.

Even though such a statute would give nonresidents just what they usually want (precise equality of treatment), the privileges and immunities clause does not require such a law -- and, more to the point, the due process clause would not permit it. While the taxing power of the States extends to all income of residents, whether earned in State or out, *see Shaffer*, 252 U.S. at 57, it does not extend to the activities of nonresidents that occur, or property that is located, outside their jurisdiction, *id.; Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n*, 390 U.S. 317, 324-25 (1968); *International Harvester Co. v. Wisconsin Dep't of Taxation,* 322 U.S. 435, 441-42 (1944).

On the income side of the equation, the States' hands thus are tied. They simply cannot extend equal income treatment to residents and nonresidents. What due process prohibits, in short, the privileges and immunities clause cannot require.

B. The States May Limit Deductions For Nonresidents To Expenses That Are Linked To The Only Income -- Namely, In-State Income -- That The States Have Power To Tax.

No doubt the States' hands are not so tied on the deduction side of the equation. They do not face the same impediment to absolute equality of treatment because taxpayers like Mr. Lunding are (not surprisingly) more than willing to offer New York jurisdiction over their out-of-State alimony expenses. But surely that does not end the inquiry. The States may account for the mandatory differences in treatment between residential and nonresidential income in determining how to allocate deductions between them, above all because the distinction is eminently reasonable in nature and because the privileges and immunities clause looks not to "theoretical distinctions" but to the overall "practical effect and operation of the respective taxes as levied." *Shaffer*, 252 U.S. at 56.

That is all New York has done here. It has treated the Connecticut-based alimony expense just like the Connecticut-based income -- as unrelated to the New York-based income and therefore as undeserving of a New York-based deduction. While New York could adopt other methods of taxation, the privileges and immunities clause does not compel it to do so. Since New York may tax only those portions of the nonresident's income arising from a business within New York, the State acts well within its power by

taxing the full in-state income of the nonresident without granting deductions for personal expenses unrelated to the generation of that income. Quite simply, the privileges and immunities clause does not require individuals subject to different tax burdens to be afforded the same tax relief or what is worse -- compel States to allow nonresidents to slice off the benefits but not the burdens of residential status.

Nor will this approach have any more than a *de minimis* effect on the run-of-the-mill taxpayer or comity among the States. Indeed, petitioners' proposed rule would not even lessen the general tax burden on individual taxpayers, but merely shift revenue from New York to the State where the taxpayer resides. Today, 39 States (including Connecticut) have an income tax, and each of them provides a deduction or credit to residents for income-tax payments to other States. Thus, a personal expense deduction granted by New York to the nonresident (*e.g.*, for alimony) lowers the New York tax, but at the same time also lowers the deduction or credit in the State of residence. All things being equal, then, the taxpayer would pay roughly the same total tax in the two States, the only difference being that Connecticut would get more and New York less of the revenue.

The net effect of the alimony deduction would not be tax relief, but transfer of revenue to the State of residence. Far from furthering the goals of the privileges and immunities clause, such a constitutionally-compelled tax structure would simply lead to a systematic shift of revenue out of the States where the taxpayers actually earn their income. Although the States may agree to such a shift of revenue, no constitutional policy dictates it.

III. The Court Has Already Approved Similar State Tax Distinctions Between Residents And Nonresidents.

Not only do the Court's general teachings in this area support New York, so also do its specific instructions. In *Shaffer v. Carter*, 252 U.S. 37 (1920), the Court addressed a case very much like this one. At issue was an Illinois corporation's complaint that Oklahoma failed to allow it to deduct losses incurred outside the State in computing its Oklahoma income tax.

The Court rejected the claim of out-of-State discrimination. "The difference" between the two taxpayers, the Court held,

> is only such as arises naturally from the extent of the jurisdiction of the state in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination.

Id. at 57. Continuing, the 8-1 Court reasoned that the differential treatment reflected a difference in kind between the tax obligations of the two entities.

> As to residents [the State] may, and does, exert its taxing power over their income from all sources, whether within or without the state, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to nonresidents, the jurisdiction extends only to their property owned within the state and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no reason to

accord them a deduction by reason of losses elsewhere incurred.

Id.

Like *Shaffer*, *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920), also concluded that "there is no unconstitutional discrimination against citizens of other states in confining the deduction of expenses, losses, etc. in the case of nonresident taxpayers, to such as are connected with income arising from sources within the taxing state." *Id.* at 75-76. *Travis*, then, also upheld a New York provision limiting a nonresident's income tax deductions to expenses "connected with income arising from sources within the state." *Id.* at 73. *See also* M. McIntyre & R. Pomp, *State Income Tax Treatment of Residents and Nonresidents Under the Privileges and Immunities Clause*, 13 State Tax Notes 245 (July 28, 1997).

Nor do any of the statutes the Court has invalidated under the privileges and immunities clause parallel the New York law. *See, e.g.*, *Supreme Court of New Hampshire v. Piper*, 470 U.S. 274 (1985) (invalidating bar on the practice of law by nonresidents but not residents); *Austin v. New Hampshire*, 420 U.S. 656 (1975) (invalidating a commuter tax imposed on nonresidents but not residents); *Toomer v. Witsell*, 334 U.S. 385 (1948) (invalidating a license fee 100 times greater for nonresidents than for residents); *Travis, supra* (invalidating State's denial of standard, as opposed to personal expense, exemptions to nonresidents).

IV. A Contrary Approach Would Jeopardize Innumerable State Tax Laws.

Adoption of petitioners' argument also raises the specter that a host of State laws and regulations relying on

this distinction will be placed at risk. The States have enacted a wide array of tax laws that situs items of personal expense outside the State while permitting nonresidents to deduct the proportionate share of business and occupational expenses related to the generation of in-state income. Whether it be in the context of moving expenses, medical expenses, qualified retirement contributions, or other personal expenses, New York's distinction between residents and nonresidents is as widespread as it is time-honored. *See Matter of Goodwin*, 286 A.D. 694, 146 N.Y.S. 2d 172 (1955) (upholding denial to nonresident of deduction for real estate taxes on out-of-state home, mortgage interest on out-of-state home, medical expenses and life insurance premiums), *appeal dismissed*, 352 U.S. 805 (1956); *Stiles v. Currie*, 118 S.E.2d 428 (N.C. 1961) (upholding disallowance to nonresident of deduction for all expenses not related to in-state income); *Berry v. State Tax Comm'n*, 397 P.2d 780 (Or. 1964) (disallowance of deduction for medical expenses of nonresident upheld), *appeal dismissed*, 382 U.S. 16 (1965), *questioned*, *Wood v. Dep't of Revenue*, 749 P.2d 1169 (Or. 1988); *Anderson v. Tiemann*, 155 N.W.2d 322 (Neb. 1967) (personal deductions may be allowed to residents and denied to nonresidents), *appeal dismissed*, 390 U.S. 714 (1968); *Harris v. Commissioner of Revenue*, 257 N.W.2d 568 (Minn. 1977) (upholding denial of moving expense deduction to person moving out of State on ground that deduction must relate to production of income taxed by the State); *Taylor v. Conta*, 316 N.W.2d 814 (Wis. 1982) (upholding denial of moving expenses and recapture of capital gain on sale of house).

Several States, moreover, adhere to this distinction in the precise setting of alimony deductions. For example, Alabama, California, Illinois, Ohio, West Virginia, and Wisconsin all to one degree or another place limits on the deductibility of alimony expenses by nonresidents. *See* Ala.

Code 40-18-15(18) (1993 and 1996 Supp.); Cal. Rev. and Tax. Code 17302 (1988 and 1996 Supp.); Ill. Comp. Stat. Ann. C. 35 5/301(c)(2)(A) (Smith-Hurd 1996 and 1997 Supp.); Ohio Rev. Code Ann. 5747.20(B)(6) (Page's 1996); W. Va. Code Ann. 11-21-32(b)(4) (1995); Wis. Stat. Ann. 71.05(6)(a) (West 1989 and 1996 Supp.).

Even the United States itself honors this distinction. Section 873 of the Internal Revenue Code allows federal income tax deductions to aliens only to the extent the expenses are connected to income arising within the United States. The differential treatment has been understood to comply with United States treaty obligations mandating equal treatment of foreign taxpayers. *See* M. McIntyre & R. Pomp, *State Income Tax Treatment of Residents and Nonresidents Under the Privileges and Immunities Clause*, 13 State Tax Notes 245, 247-49 (July 28, 1997).

CONCLUSION

For the foregoing reasons, the *amici* States respectfully urge the Court to affirm the decision of the New York Court of Appeals.

Respectfully submitted,

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